



**JIM STRICKLAND
MAYOR**

**DIVISION OF HOUSING &
COMMUNITY DEVELOPMENT**

October 17, 2018

Mary C. Wilson
Director, Office of Community Planning and Development
U.S. Department of Housing and Urban Development
Knoxville Field Office, Region IV
710 Locust Street, Suite 300
Knoxville, TN 37902-2526

Dear Ms. Wilson:

This letter is in response to the September 4, 2018 HUD letter regarding findings of noncompliance with HOME program requirements. The letter concerned commitment and eligibility issues for two HOME activities, Marina Cove (HOME activity 12587) and Cleaborn Pointe (HOME activity 13033). The letter calls for the deobligation of \$8,989,283.62 in HOME funds and the potential repayment of \$6,881,771.21 by the City of Memphis from nonfederal funding sources. After extensive review of the projects, the City agrees with HUD that technical violations occurred when carrying out both projects.

The City's Division of Housing & Community Development (HCD), which administers HOME funds, identified project documents not yet reviewed by HUD and created detailed timelines that organize these documents. The enclosed documents include budgets, letters, agreements, and other items that provide a clearer picture of how both projects transpired. The City believes these documents demonstrate that the City made good faith efforts to identify and commit funds to HOME eligible projects, and to complete both projects in accordance with established rules, despite any errors made in implementation. Both projects resulted in quality affordable housing units for HOME eligible beneficiaries in previously blighted communities.

Following HUD's review of the enclosed additional supporting documentation for these projects, the City requests reconsideration of the proposed corrective actions as the projects fulfill the HOME program's goals for developing affordable housing for income eligible occupants. The current corrective actions would inhibit the City's efforts in providing affordable housing and burden residents through a substantial loss of funding in the City's budget and stalling housing and neighborhood improvements for several years. The City understands HUD's rationale for proposing the deobligation of \$8,989,283.62 as the commitments for these projects were initially viewed as ineligible. However, the City does not believe a repayment of the \$6,881,771.21 in expenditures for these projects is necessary if HUD deobligates the full amount of funds committed to these projects. The City understands deobligation as the recapture of all expended and unexpended funds committed to these projects. Repayments of expended funds, in addition to all committed funds, would double the amount of HOME funds recaptured by HUD.

Researching these projects spurred HCD staff to map existing processes and identify areas for improvement that ensure valid written agreements are executed for eligible projects prior to committing HOME funds in IDIS. The City is currently working with CorporateFACTS, a HUD Tier I certified technical assistance provider, on financial account reconciliation, which will be followed by process improvement coaching. While several process improvements will result from future technical assistance provided by both CorporateFACTS and HUD, some preliminary recommendations under consideration include:

- Adding an additional layer of review by mandating a City division outside of HCD sign off before any HOME commitments are entered into IDIS. This independent, third party review will ensure that all necessary steps are completed and all written agreements comply with HUD regulations prior to committing funds to a project.
- Realigning HOME program activities under a department dedicated to the HOME program and assigning a staff compliance specialist to work solely with that department on HOME related activities. This will be coupled with a strategic training series aimed at enhancing HOME expertise within HCD.
- Increasing quality control in the commitment of HOME funds by reducing the number of employees that currently have permission to commit funds in IDIS and utilizing a standardized process and tools for entering detailed information into IDIS.
- Committing City or CDBG funds for acquisition and predevelopment costs on future projects with uncertain budgets and funding sources, instead of HOME funds.

These preliminary steps are being taken to correct deficiencies in the City's administration of the HOME program and to ensure compliance with all regulations. As with any instance where HUD identifies issues with the City's administration of funds, the City is dedicated to taking action to resolve outstanding issues with these projects, including correcting executed written agreements and completing missing documents. The City's ability to follow through with corrective action plans is evidenced by its satisfactory clearance of deficiencies related to HUD's 2015 HOME Environmental Review findings, which included the Marina Cove and Cleaborn Pointe projects. In this instance, HUD cleared findings related to these issues in December 2016 by working with the City to improve processes, increase program knowledge through technical training, and allowing the City to complete the insufficient Environmental Reviews. The City believes that a similar workout plan would be appropriate for this scenario after HUD's review of the enclosed information.

Marina Cove (HOME activity 12587)

The Marina Cove project consisted of the demolition of a vacant and blighted 24-acre apartment complex, which was intended to be redeveloped as a mixed-use town center anchored by multifamily housing, a school, and retail. The City of Memphis partnered with Power Center CDC on this project following a series of environmental court hearings aimed at securing the property, addressing health and pest concerns, and negotiating a fair deal for transferring the condemned property. Initially, the City included details for this project in its Neighborhood Stabilization Program II application to HUD in July 2009. The City did not receive the grant. In July 2010, Power Center CDC purchased the property with nonfederal CIP funding provided by the City. This project faced financial challenges when it did not receive Low-Income Housing Tax Credits for multifamily housing, as communicated to HUD in a 2015 letter. This tax credit denial prompted the change in project scope to single family housing to ensure that the mandatory affordable housing units were built. In June 2017, nine (9) affordable housing units were completed with HOME eligible occupants currently living in the homes.

HUD Finding 1

HUD finds that the City did not follow HOME regulations at sec. 92.502(b) requiring the City to commit funds to a “specific local project” within the meaning of the definition of commitment in sec. 92.2. HUD finds that the City did not follow these regulations on two occasions, with an initial commitment of \$1,700,000 on July 23, 2010 and when \$931,000 was committed on July 28, 2016.

City Response

The City agrees with HUD that the commitment of HOME funds occurred prior to the execution of the necessary written agreements. While there was language in the Trust Deed securing the City and HUD’s interest in developing affordable housing, it was insufficient per the regulations. Ultimately the City executed written agreements with the project developer that incorporated HOME language; however, these written agreements should have preceded the commitment.

Corrective Action

The City is in the process of updating policies and procedures to avoid making this mistake in the future. Following are a list of actions the City has completed and is undertaking:

- To improve project review and the development of valid written agreements, the City now requires that all applications submitted for HOME funding are reviewed per CPD-15-11 and the corresponding checklist before executing written agreements and committing funds in IDIS;
- Incorporating an independent 3rd party review by the City of Memphis Finance Division to ensure that necessary documentation and language is incorporated into the written agreement before commitment;
- Ensuring that all applications are reviewed by the project review committee prior to the execution of written agreements;
- The City hired Corporate Facts, a HUD approved TA provider, to reconcile the City’s accounts with IDIS and map all processes related to the HOME program to identify improvements;
- The City requested technical assistance from HUD for staff training and further process improvement;

HUD Finding 2

The City violated underwriting and subsidy layering provisions at 92.250(b), which requires a PJ to evaluate the project in accordance with guidelines that it has adopted for determining a reasonable level of return on investment in a HOME-assisted project.

City Response

The City completed subsidy layering analyses and cost allocations at various points over the development of this project, but failed to properly document these reviews and did not include all the required documents in the original files sent to HUD. The City is providing this information as a part of the Marina Cove attachment.

Corrective Action

The corrective actions included under Finding 1 will help to ensure that there are documented records for subsidy layering analysis and cost allocation included with all project files. Additional corrective actions include improving processes for updating subsidy layering and cost allocation documentation when projects change and prior to committing additional funding in IDIS.

HUD Finding 3

The City's written agreements and amendments committing funds to IDIS activity 12587 did not meet the requirements for such agreements established at 92.504(c)(3).

City Response

The City agrees that written agreements and amendments did not contain all the required information. The City is providing this information as a part of the Marina Cove attachment to this letter. As noted earlier, the City eventually obtained this information and the errors occurred as a matter of understanding process than willful disregard. Additionally, the City had this information when HUD made its request for documentation, but the City did not understand the full scope of documentation to send in response. The City hopes that the attachments are sufficient for HUD and show a good will effort at meeting technical issues required for executing valid written agreements.

Corrective Action

The corrective actions included under Finding 1 will work to ensure that written agreements specifically address the deficiencies noted under this finding; Specifically, utilizing the written agreement checklist CPD-15-11 provided by HUD for ensuring all supporting documentation is completed prior to executing a valid written agreement and committing funds in IDIS.

HUD Finding 4

The City set up activity 12587 in IDIS and expended funds before it executed a written agreement for the project in violation of 92.504(b), which requires execution of a written agreement before HOME funds can be disbursed.

City Response

The City concurs with HUD's finding for the initial commitment of funds to this activity. Although the City's second commitment of funds to this activity occurred prior to the execution of the amendment to the written agreement, funds were not disbursed until after the amendment was executed.

Corrective Actions

The City is improving its policies and procedures to treat amendments to written agreements as applications, which must be reviewed by the review team, comply with CPD-15-11, and be checked by an independent 3rd party prior to committing funds in IDIS, thus avoiding the disbursement of funds to a project with a noncompliant written agreement.

HUD Finding 5

The City funded HOME activity 12587 in amounts that exceeded the amount committed to the activity in its written agreement and amendments, in violation of 92.504(b). This increased the amount HUD credited the City for meeting the 24-month commitment deadline for multiple years, leading to a cascade of shortfalls between 2008-2013.

City Response

The City does not dispute that the project activity was funded at a higher amount than was ultimately utilized; however, the project was anticipated to be more robust than the final development completed. The project developer aimed to use low income housing tax credits to build a larger multifamily development, which would have required HOME funding at the level committed to the project. While the City now understands that the commitment of funds should not have been made until the tax credits were secured, this was the reason that the HOME funding committed to the project was higher than the proceeds actually used.

Corrective Action

The City will establish a new protocol for executing HOME commitments and ensure that the subsidy layering analysis, cost allocation and other underwriting documents are utilized when making commitments.

HUD Finding 6

The City expended HOME funds for ineligible costs in violation of 92.214(a)(9) because the City was reimbursed for \$1,303,277.30 related to the improvement of a 24-acre site through the demolition of the Marina Cove apartments, site grading, drainage, and construction of a storm water basin, while the affordable housing development only occupied 1.5 acres at the end of the project. Expenses billed to the HOME program for the full-site, excluding the 1.5 acres, are ineligible HOME expenses. An additional \$61,649.12 was drawn from IDIS against this activity without the documentation supporting this draw as an eligible HOME expense

City Response

The full cost of demolition was estimated at \$2,474,230.17 of which \$1,303,277.30 was reimbursed by HOME funds. The City believed that because the project would be a mixed-use development, that this would be an eligible use of funds under section 92.205(d) if the HOME units were built on the site. This project is located in a neighborhood that has a suburban style of development. While mixed-use developments in more densely populated areas may be inside of a single, multi-story, vertical structure, in this community the mixed-use concept envisioned was horizontal with an array of uses in numerous adjacent structures on the site. While the housing units only exist on 1.5 acres of the 24-acre site, the whole site had to be demolished to make these housing units possible. While the City now understands, and agrees with, HUD's interpretation of the rules regarding this finding, the City previously believed that this project was completed under an allowable approach since there had been communication with the HUD Field Office on the challenges related to this project. This includes the shift from a multifamily project, which would have taken up significantly more acreage, to a nine-unit single family project on 1.5 acres.

Corrective Action

The City is amending its procedures and processes to ensure ineligible costs are identified before the commitment of HOME funds.

Other Requested Documentation

Under HUD's corrective actions for Marina Cove, HUD requested the following to establish eligibility for the completed homes:

- Documentation that units were acquired by HOME income-eligible homebuyers
- Executed Homebuyer agreements that impose the requirements at 92.254
- Documentation of Resale or Recapture provisions imposed on the properties
- Documentation that property standards meet the requirements in 92.251

City Response

The City has included documents that established eligibility as a part of the Marina Cove attachment to this letter.

Cleaborn Pointe (HOME activity 13033)

Cleaborn Pointe was developed in partnership with the Memphis Housing Authority (MHA) as a part of a HOPE VI redevelopment project of the former Cleaborn Homes public housing development with multiple sources of local and federal funds. The HOPE VI project was awarded in June 2010. The project consisted of six (6) phases with varying number of units developed in each phase. The City committed to providing gap funding to the project from both local and federal sources as a part of the initial application. In May 2011, the City entered into a Master Development Agreement (MDA) with MHA in order to have a blanket agreement through which funds could be provided for the project. Initially, the project was slated to include proceeds from a tax increment financing (TIF) district; however, political issues ended the establishment of the TIF district. In May 2013, then-Mayor of the City of Memphis, AC Wharton, received a memorandum requesting a resolution to cover an \$8 million funding gap for the project. Many factors contributed to the shortfall, including the failure to establish a TIF district that would include the project site and a reduction in the amount of tax credit equity to be received. In August 2013, HOME was introduced to the project through the second amendment to the MDA. For each phase of development in which HOME proceeds were utilized, tax credit loan documents show that HOME provisions were included in an agreement between MHA and the tax credit partners. While the project ultimately utilized roughly half of the total HOME funding committed in IDIS, the various gaps experienced in the project demonstrate that there was a reasonable anticipation that these funds were needed to complete the final development. The final development includes 22 HOME units. The City has documentation for 13 of the 22 units in written agreements. The City is working to verify that the remaining units, identified in Attachment 21 of the Cleaborn Pointe Checklist, are HOME-assisted, and will update the written agreements to reflect this omission.

HUD Finding 1

HUD finds that the City did not follow HOME regulations at sec. 92.502(b) requiring a City commit funds to a specific local project within the meaning of the definition of commitment in sec. 92.2.

City Response

The City concurs that the commitment of HOME funds occurred prior to the execution of written agreements that meet the definition of commitment. The City ultimately executed the agreements through the MDA and the HOME restrictions are effectively tied to the project through tax credit loan documents, as demonstrated in the Cleaborn Pointe attachment.

Corrective Action

The City is in the process of updating policies and procedures to avoid making this mistake in the future. Following are a list of actions the City has completed and is undertaking:

- To improve project review and the development of valid written agreements, the City now requires that all applications submitted for HOME funding are reviewed per CPD-15-11 and the corresponding checklist before executing written agreements and committing funds in IDIS.
- Incorporating an independent 3rd party review by the City of Memphis Finance Division to review ensure that necessary documentation and language is incorporated into the written agreement before commitment.
- Ensuring that all applications are reviewed by the project review committee prior to the execution of written agreements.
- The City hired Corporate Facts, a HUD approved TA provider, to reconcile the City's accounts with IDIS and map all processes related to the HOME program in order to identify efficiencies.
- The City requested technical assistance from HUD for staff training and further process improvement.

HUD Finding 2

The City violated the underwriting and subsidy layering provisions at 92.250(b) which requires a PJ to evaluate the project in accordance with guidelines that it has adopted for determining reasonable level of return and investment in a HOME-assisted project. The City did not provide justification for its investment of \$8,811,386.94, no examination of sources and uses of funds, no determination of costs reasonableness, and no assessment of market demand.

City Response

The City did not understand the scope of documentation HUD requested in its initial correspondence. The city is now providing underwriting and subsidy layering documentation for Cleaborn Pointe and hopes that HUD finds the documentation to be sufficient for a valid written agreement.

Corrective Action

The City will ensure that this information is included as a part of all project files in the future by using the checklist CPD-15-11 provided by HUD for developing valid written agreements in addition to the corrective actions outlined under Finding 1 aimed at improving overall management of the HOME program.

HUD Finding 3

The City entered a project commitment amount for activity 13033 that exceeded the amount it had committed to the activity in its written agreement and amendments in violation of 92.504(b), which inaccurately increased the total amount of commitments that credited the City in determining if the City met the 24-month commitment deadline. HUD believes these commitments establish a pattern where the City over committed funding to projects in order to meet the 24-month commitment deadline because these commitments occurred in conjunction with 4 month and 1 month shortfall notices, approximately averaged the City's entire entitlement funding for the year, and the City eventually uncommitted \$4,225,542.15 from this activity in 2018. This pattern contributed to HUD's determination that the City missed its commitment deadline for multiple years between 2008-2013.

City Response

The City understands HUD's perception that commitments to the Cleaborn Pointe project were a means to avoid a commitment shortfall if the City violated the 24-month commitment deadline. Attached are two letters from the then-Director of Housing and Community Development/Memphis Housing Authority to then-Mayor AC Wharton. The letter dated May 16, 2013 shows that project faced a \$25 Million gap due to shortfalls in CIP funding and the failure to establish a TIF district. The City found sources and methods to reduce the gap to \$8 Million while attempting to preserve federal funds at HCD and comply with all federal regulations. The then-Director of HCD wrote the then-Mayor of Memphis on March 10, 2014, that additional sources are needed to close the funding gap, seeking \$4.5 Million in city funds. As noted by HUD, the Open Activity Report shows that the City committed additional funds as follows:

March 31, 2013	\$2,500,000	June 30, 2014	\$6,335,000
April 30, 2013	\$4,400,000	February 28, 2015	\$6,335,000
May 31, 2014	\$4,635,000	March 31, 2015	\$8,811,386.94

The City understands why HUD perceives these commitments as an effort to avoid losing uncommitted funding. However, based on the timing of letters sent to the then-Mayor concerning financing issues, the City believes that it attempted to use HOME funds appropriately and only as needed to close what was believed in 2013 to be an \$8 Million funding gap.

Corrective Action

The City believes that the documentation included as a part of the Cleaborn Pointe attachment will provide a clearer picture of how this project progressed. This should demonstrate that the project's need drove the additional HOME commitments. Process improvements outlined under Finding 1 will help the City avoid similar findings in the future and the City will improve its monitoring the Open Activities Report available on HUD Exchange.

HUD Finding 4

The City's written agreements and amendments committing funds to IDIS activity 13033 did not meet the requirements for such agreements established at 92.504(c)(3), which requires written agreements committing HOME funds to projects to contain addresses, or legal descriptions, project budgets and construction schedules that include sufficient milestones for monitoring performance. Neither the Master Development Agreement, nor any of the amendments imposed HOME requirements on the project, as required in 92.504(c)(3).

City Response

The City included requisite HOME language in amendments to the MDA, although the language may not meet all the regulatory standards. This is included in the Cleaborn Pointe attachment for HUD review.

Corrective Action

The process improvements outlined within this letter will help the City avoid findings of this nature in the future.

HUD Finding 5

The City has not maintained or provided supporting documentation for the current total HOME expenditure of \$4,585,844.79 in violation of 92.508(a)(3)(ii) as only 8 of 22 addresses entered into IDIS are included in the November 12, 2014 written agreement.

City Response

The City identified a total of 22 HOME-assisted units and 13 are included in the written agreements for this project through amendments to the Master Development Agreement. The City thought that all amendments to the Master Development Agreement were included in the initial submission and did not know until the September 2018 meeting with the Office of Affordable Housing that this document was missing. The missing portion identifying the remaining HOME-assisted units is attached to this letter with a spreadsheet identifying the remaining eight units that need to be designated in the written agreements. The City hopes this resolves the uncertainty surrounding the HOME-assisted units at Cleaborn Pointe.

Corrective Action

The City will amend the written agreements by including all HOME-assisted units that were omitted. The city will continue with making the improvements outlined in this letter to avoid similar errors in the future.

Closing Remarks

The City believes selecting alternative corrective actions related to these projects is in the best interest of the City and HUD, and more in line with the HOME program's intent to provide safe and affordable housing for low- to extremely low-income households, by ensuring the City develops the tools and technical knowledge needed for securing long-term program compliance. HOME program regulations at 24 CFR 92.551 grant HUD considerable discretion for determining how to correct findings related to this projects. That discretion is guided by the following directive: **"Corrective or remedial actions for performance**

deficiency will be designed to prevent a continuation of the deficiency; mitigate, to the extent possible, its adverse effects or consequences; and prevent its recurrence.” We believe these objectives can be accomplished through the corrective actions outlined in this letter, rather than through the deobligation and repayment of HOME funds.

The City is resolute in working with HUD to rectify all outstanding issues related to the Marina Cove and Cleaborn Pointe projects and improving overall management of the City's HOME program. The City acknowledges that it incorrectly carried out these projects according to HOME regulations, and hopes that it demonstrated that this was not a willful disregard for the regulations, but the result of incorrect regulatory interpretations and inadequate review processes. Through steps taken this past month, the City is identifying and codifying improvements to revise its policy and procedures manual. The City will operationalize these improvements through structural changes to ensure that subject matter expertise is maximized for HOME and other HUD-funded programs. The City hopes that the information included herein, along with these proposed changes, demonstrate that the City is dedicated to the good stewardship of HOME funds and that HUD will reconsider the proposed deobligation and repayment of HOME funds.

After HUD reviews the enclosed information, the City would like to host HUD staff from the Knoxville Field Office and the Office of Affordable Housing for a debriefing discussion on this matter in Memphis. An in-person meeting will allow HUD and the City the opportunity to work together to ensure that the subject issues are resolved and establish new foundations for the long-term effectiveness of the program. Alternatively, a conference or video call would suffice if travel costs are a barrier for the HUD team. Please, contact me at 901-576-7308 or paul.young@memphistn.gov if you have additional questions or concerns.

Sincerely,


Paul A. Young
Director

Cc: Jim Strickland, Mayor, City of Memphis
Doug McGowen, Chief Operating Officer, City of Memphis
Shirley Ford, Chief Financial Officer, City of Memphis
Virginia Sardone, Director, HUD Office of Affordable Housing
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